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Japan's Trade Surplus Shrinks

"Wipe that smile off your face" could have been the admonition from the Economic Planning Agency to exporters as Japan's latest trade statistics were released. The figures showed that Japan's trade surplus on a customs-clearance basis for July to September dropped a whopping 16.2 percent in dollar terms from the same quarter a year ago (see Tables). Some in the export community reportedly saw the news as particularly favorable since the continued narrowing of Japan's trade imbalance reduces the chance that the yen will have to rise to lower the surplus or that protectionist pressures abroad will increase.

But EPA and many other experts saw things differently. With the yen more than 6 percent weaker than a year earlier, the so-called J-curve effect continued to make the reduction in Japan's trade surplus appear greater than it really was. Dollar-denominated export prices for Japanese goods were held down by

the weak yen, and volume grew relatively slowly because of the yen's earlier appreciation. The combination of comparatively low prices and small volume gains held dollar-denominated export growth to 3.6 percent, well below the 11.9 percent jump in imports.

The influence of exchange rate movements and other price changes can be seen by comparing the dollar-denominated trade figures with the volume statistics. The volume of exports increased 4.9 percent in the third quarter from a year earlier, while imports were up 7.5 percent. The result was a modest decline in the trade surplus as measured by volume.

If the J-curve was not enough to dash the spirits of exporters, the figures on trade with the United States might have been. The dollar-denominated bilateral surplus dropped 5.8 percent but rose if measured in yen. From EPA's point of view the discouraging part of the bilateral results is the fact that the percentage of Japan's overall surplus generated by trade with the United States has been going up. A year ago the United States accounted for 62 percent of the total surplus; in this year's July-September quarter the figure was 70 percent. These numbers, along with a comparable trend in the U.S. trade picture, suggest to EPA officials that U.S. protectionsist pressures are likely to continue unabated.

Finally, many experts fear that the good news, even of the latest heavily qualified kind, is mostly behind Japan. As evidence, these analysts point out that the value of the yen, which went virtually straight up against the dollar between late 1985 and 1987, leveled off in 1988 and has fallen modestly this year. With inflation rates in Japan and elsewhere low, these twists and turns of the nominal exchange rate generally have conformed to the direction of the real exchange rate that affects trade imbalances. If, as many researchers feel, exchange rate effects take at most two or three years to be fully reflected in trade statistics, Japan's imbalance could be feeling the last of the yen's strength in 1987 and is about to be dominated by the currency's more recent weakness.

The drops in Japan's trade surplus in the last two quarters are expected to keep the number for fiscal year 1989, which ends next March 31, below that registered in FY 1988, but after that all bets are off. Nomura Research Institute, for example, sees Japan's trade surplus dipping from $95.3 billion in FY 1988 to $86.7 billion in FY 1989 before rising in FY 1990 to $91.9 billion. (Imports here are measured on a free-on-board basis rather than the cost, insurance and freight basis used in the customs-clearance figures.) Of course, such forecasts depend critically on future exchange rates and the health of the Japanese economy and its trading partners. Should the Japanese economy unexpectedly weaken, for example, demand for imports in Japan would be correspondingly less and the surplus wider. Should that not altogether impossible prospect loom, the grim faces could stretch from Tokyo to Washingon.

Douglas Ostrom

Japanese Banks Enmeshed In Mergers And Acquisitions

With vast pools of cash to invest and only low-yielding domestic opportunities, Japanese banks have been drawn irresistably to the potentially high

Japan's Total Trade in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1984	$170,114	15.8%	$136,503	8.0%	$33,611
1985	175,638	3.2	129,539	-5.1	46,099
1986	209,151	19.1	126,408	-2.4	82,743
1987	229,221	9.6	149,515	18.3	79,706
1988	264,917	15.6	187,354	25.3	77,563
1987: I	51,464	13.1	31,977	-3.1	19,487
II	56,931	7.1	36,380	15.8	20,551
III	57,855	5.6	38,346	27.2	19,509
IV	62,972	13.0	42,812	34.5	20,159
1988: I	60,279	17.1	44,505	39.2	15,774
II	65,179	14.5	47,260	29.9	17,919
III	67,169	16.1	47,258	23.2	19,911
IV	72,291	14.8	48,331	12.9	23,960
1989: I	68,247	13.2	51,147	14.9	17,100
II	67,632	3.8	51,272	8.5	16,360
III (p)	69,574	3.6	52,885	11.9	16,689

Japan's Total Trade in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1984	Y40,325	15.5%	Y32,321	7.7%	Y8,004
1985	41,956	4.0	31,085	-3.8	10,871
1986	35,290	-15.9	21,551	-30.7	13,739
1987	33,315	-5.6	21,737	0.9	11,578
1988	33,939	1.9	24,006	10.4	9,933
1987: I	7,960	-8.2	4,959	-21.7	3,002
II	8,153	-10.6	5,207	-3.6	2,946
III	8,507	-1.5	5,644	18.6	2,864
IV	8,694	-1.9	5,928	17.2	2,767
1988: I	7,713	-3.1	5,688	14.7	2,025
II	8,163	0.1	5,918	13.6	2,246
III	8,924	4.9	6,280	11.3	2,644
IV	9,139	5.1	6,121	3.3	3,018
1989: I	8,707	12.9	6,516	14.6	2,191
II	9,226	13.0	6,994	18.2	2,232
III (p)	9,908	11.0	7,524	19.8	2,383

Japan's Trade with the United States in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1984	$59,937	39.9%	$26,862	9.0%	$33,075
1985	65,278	8.9	25,793	-4.0	39,485
1986	80,456	23.3	29,054	12.6	51,401
1987	83,580	3.9	31,491	8.4	52,090
1988	89,634	7.2	42,037	33.5	47,597
1987: I	18,001	7.8	6,986	11.3	11,015
II	21,181	1.2	7,592	-8.6	13,589
III	21,628	1.6	8,252	9.7	13,376
IV	22,770	5.6	8,660	24.7	14,110
1988: I	19,859	10.3	10,090	44.4	9,769
II	21,610	2.0	10,458	37.8	11,152
III	23,056	6.6	10,667	29.3	12,389
IV	25,109	10.3	10,821	25.0	14,288
1989: I	22,728	14.4	11,566	14.6	11,162
II	23,011	6.5	12,065	15.4	10,946
III (p)	24,092	4.5	12,417	16.4	11,676

Japan's Trade with the United States in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1984	Y14,221	39.7%	Y6,364	8.7%	Y7,858
1985	15,583	9.6	6,213	-2.4	9,369
1986	13,564	-13.0	4,918	-20.9	8,646
1987	12,148	-10.4	4,582	-6.8	7,566
1988	11,487	-5.4	5,388	17.6	6,099
1987: I	2,786	-12.7	1,083	-9.9	1,703
II	3,034	-15.5	1,086	-23.6	1,948
III	3,180	-5.2	1,215	2.1	1,965
IV	3,148	-8.2	1,198	8.5	1,950
1988: I	2,541	-8.8	1,290	19.1	1,251
II	2,706	-10.8	1,309	20.5	1,397
III	3,063	-3.6	1,418	16.7	1,645
IV	3,177	0.9	1,371	14.4	1,806
1989: I	2,900	14.1	1,474	14.2	1,426
II	3,141	16.1	1,649	25.9	1,493
III (p)	3,432	12.0	1,766	24.6	1,666

returns offered by the U.S. mergers and acquisitions market. Japanese banks are increasingly visible, especially in the mega-deals that have gotten wide coverage in the American press. As some Japanese banks are discovering, however, the risks, both economic and political, of playing the leveraged buyout game are at least as high as the anticipated returns.

The attractions of financing a leveraged buyout are obvious: in addition to a high rate of interest (anywhere from 1 percentage point to 3 points above the London Interbank Offered Rate), up-front fees can be as hefty as another 2 percent of the loan amount. Combined with loan maturities of as little as three months, backing a LBO can be a quick way to turn a profit.

According to some American estimates, Japanese financial institutions already have lent as much as $20 billion for U.S. mergers and acquisitions and have committed another $35 billion. When both outstanding loans and commitments are combined, Japanese banks may control as much as 25 percent of the American LBO market. (The U.S. bank share is estimated at 52.6 percent.) According to data from Japanese banks collected by Nihon Keizai Shimbun, Japan's role is growing steadily (see Table). Japanese banks already are acting as coleaders in arranging LBO financing; most observers expect them to act as lead organizers in the near future.

According to the figures in the table alone, Sanwa Bank, Ltd.'s exposure totals over $1.3 billion, with Fuji Bank, Ltd. close behind at just under $1.2 billion. Based on information filed with the Securities and Exchange Commission, Mitsubishi Bank, Ltd. has sunk almost $1.6 billion into the American LBO market. Despite rapid growth over the past few years, most observers agree that the total exposure of Japanese financial institutions in the U.S. LBO market remains small compared to their total overseas assets, somewhere in the range of 4 percent.

Despite their success in other fields, everything Japanese financial institutions touch does not turn to gold. Campeau Corp.'s recent financial troubles have cast a cloud over the $1.5 billion lent by Japanese banks to finance the Canadian real estate developer's buyout of Federated Department Stores Inc. Ever since Japanese banks provided a significant share of the funds that permitted Kohlberg Kravis Roberts & Co. to swallow huge RJR Nabisco Inc. earlier this year, however, the Bank of Japan has been cautioning domestic banks to examine each deal with a magnifying glass. A number of analysts in Japan are raising warning flags that many smaller banks, leasing firms and insurance companies, having bought U.S. junk bonds high before the market's October 13 plunge, may be in over their heads.

The role of Japanese banks and Tokyo in the October 13 equity market decline also is being closely examined. Most American press reports hinted that the Ministry of Finance expressed concern about the growing exposure of Japanese financial firms to the vagaries of the U.S. junk bond market. This "warning," so the story went, made Japanese banks more cautious about participating in the $6.8 billion buyout of UAL Inc. Instead of committing $3 billion as expected, Japanese backers pledged only $1 billion. This, according to American papers, caused the buyout plan to unravel, pulling the rug out from under UAL's stock and setting off a wave of selling on the New York Stock Exchange.

The Ministry of Finance has strongly denied issuing any sort of guidance to Japanese banks to restrain their LBO activities, apparently concerned that

Japanese Participation in Major American Mergers and Acquisitions

(funding commitment in millions of dollars in parentheses)

Date and Transaction	Japanese Participants
April 1988 - Kodak Inc.'s purchase of Sterling Drug Inc. for $5.1 billion	Fuji Bank (300) Industrial Bank of Japan (300) Mitsubishi Bank (200) Sumitomo Bank (200) Tokai Bank (200)
Total Japanese commitment: $1.5 billion	
July 1988 - Campeau Corp.'s purchase of Federated Department Stores Inc. for $6.5 billion	Sanwa Bank (500) Sumitomo Bank (500) Bank of Tokyo (150) Long-Term Credit Bank of Japan (150) Nippon Credit Bank (150)
Total Japanese commitment: $1.45 billion	
April 1989 - Kohlberg Kravis Roberts & Co.'s purchase of RJR Nabisco Inc. for $25.1 billion	Dai-Ichi Kangyo Bank (550) Fuji Bank (550) Long-Term Credit Bank of Japan (550) Sanwa Bank (550)
Total Japanese commitment: $6.2 billion	
July 1989 - Time Inc.'s purchase of Warner Communications Inc. for $14 billion	Dai-Ichi Kangyo Bank (225) Fuji Bank (225) Industrial Bank of Japan (225) Mitsubishi Bank (225) Nippon Credit Bank (225) Sanwa Bank (225) Tokai Bank (225)
Total Japanese commitment: $1.975 billion	
August 1989 - Checchi/KLM purchase of NWA Inc. for $3.45 billion	Long-Term Credit Bank of Japan (200) Fuji Bank (110) Mitsubishi Bank (110) Sanwa Bank (110)
Total Japanese commitment: $1.4 billion	
September 1989 - Sony Corp.'s purchase of Columbia Pictures Entertainment Inc. for $4.3 billion	Mitsubishi Bank, Mitsui Bank, Fuji Bank, Bank of Tokyo and Industrial Bank of Japan; shares ranging from 17.5 percent to 25 percent of total financing
Total Japanese commitment: $3.55 billion	

Source: Nihon Keizai Shimbun

the incident will be used by Japan-bashers to press for restrictions on Japanese access to U.S. financial markets. Japanese banks also strongly deny any MOF influence on their decision to limit their role in the UAL deal. It was the relatively skimpy fees (ranging from 0.5 percent to 1.25 percent) and the low interest rate (1.75 points over LIBOR) that made the deal unattractive, the leader of the Japanese bank consortium argued. American and Japanese analysts agree that the collapse of the U.S. junk bond market and the souring of several LBOs will make Japanese lenders much more cautious.

In any case, it is clear that deep pockets alone are not enough to guarantee success in such a complicated and highly volatile financial market. It is equally clear that Japanese banks are now an indispensible part of the U.S. mergers and acquisitions market, a situation that poses new political and economic challenges to government and business leaders on both sides of the Pacific. U.S. ambassador to Japan Michael Armacost said to a Toyko audience October 11 that whether the United States welcomes Japanese direct and portfolio investments in the future "depends on American perceptions that the opportunities our firms or our investors have in Japan are mostly comparable to those we extend to your business community." He said that while "formal barriers to investment in Japan have been significantly reduced, informal barriers persist and they are formidable." Japan cannot afford, in Mr. Armacost's opinion, "to be regarded as offering fewer opportunities to foreign investors at home than it seeks for its own business community abroad." Addressing the same Tokyo conference, Deputy Treasury Secretary John Robson said that in order to combat growing concern in the United States "that we may be losing control of our economic independence," Tokyo must act quickly to eliminate "real or apparent barriers to foreign investment" in Japan.

Jon Choy

Japanese Companies Globalize Fund-Raising

Japanese corporations are taking advantage of several factors to broaden their search for funds at home and overseas. In an era where massive investment in research and development and capital improvements is mandatory to remain globally competitive, Japanese firms are leaving no stone unturned.

According to Bank of Japan data on the flow of funds in the Japanese economy, domestic corporations are capitalizing on their greater freedom to raise funds where the market is most advantageous. Japanese companies traditionally have relied on bank loans to finance capital and other long-term expenditures. The continuing liberalization of Japanese financial markets and corporate fund-raising regulations, however, has given corporate planners the freedom to tap other sources of funds. Table 1 shows that while loans from private and public lenders continue to account for the majority of fund procurement by Japan's corporate sector, their share dropped from 80.6 percent of all funds raised in 1985 to 62.7 percent three years later. In 1986 and 1987 Japanese firms began raising more money by issuing securities, mainly domestic bonds and stock, taking advantage of eased bond issuing rules and a rising stock market. Since 1987, however, the new domestic commercial paper market clearly has been favored by corporate financial planners. Within two years of its 1987 debut, the domestic CP market supplied 14 percent of all funds raised by the corporate sector.

Table 1: Fund Procurement by Japan's Corporate Sector

(in billions of yen)

	1985		1986		1987		1988	
	Value	Share	Value	Share	Value	Share	Value	Share
Borrowing From:								
Private Financial Institutions	Y22,980	77.2%	Y26,290	78.7%	Y25,770	60.4%	Y30,110	55.6%
Public Financial Institutions	1,010	3.4	550	1.6	1,960	4.6	3,860	7.1
Total	23,990	80.6	26,840	80.3	27,730	65.0	33,980	62.7
Securities								
Industrial Bonds	680	2.3	1,580	4.7	2,360	5.5	1,610	3.0
Stocks	2,020	6.8	2,210	6.6	4,120	9.7	5,230	9.7
External Bonds	2,350	7.9	2,590	7.7	3,760	8.8	4,280	7.9
Total	5,050	17.0	6,370	19.1	10,250	24.0	11,120	20.5
Commercial Paper	0	0.0	0	0.0	1,700	4.0	7,590	14.0
Foreign Debt	740	2.5	200	0.6	3,000	7.0	1,510	2.8
Total	29,770	100.0	33,420	100.0	42,680	100.0	54,190	100.0

Source: Bank of Japan

According to data from the Tokyo Stock Exchange (see Tables 2 and 3), Japanese companies clearly shop around for the best venue to float their bonds. In the domestic market convertible bonds and stock issues are the favored fund-raising tools as companies take advantage of the TSE's rapid rebound from the October 1987 crash. The local market for warrant bonds (which also might be expected to benefit from the TSE's record-breaking performance), however, runs a poor second to the overseas warrant bond market. The key difference is that arranging a warrant bond issue in Japan remains more complicated and expensive than doing it overseas despite efforts by the Ministry of Finance to liberalize the domestic market. As a result, issues of warrant bonds in foreign markets, mainly European, have tripled their share of total funds raised over the last four years.

The TSE data also confirm the rapidly growing role of the domestic commercial paper market. In its first year of operation, 1987, the market generated funds equivalent to 14.8 percent of all money raised that year through the combined domestic and overseas securities markets. Last year Japanese firms tapped the CP market for cash equal to 62 percent of the funds they raised from bonds and stocks worldwide.

Both the Bank of Japan data and the TSE figures show that the domestic market remains the main source of funds for Japanese companies. Looking only at the directly comparable bond market figures, the local market still outweighed the overseas market by a margin of Y5,007.5 billion to Y4,821.4 billion ($35.8 billion versus $34.4 billion at Y140=$1.00) in 1988. According to one of Japan's leading daily newspapers, however, this may no longer be true. Nihon Keizai Shimbun reported October 20 that, by its estimates, Japanese corporations raised more funds on overseas bond markets than at home between April and

Table 2: Fund Procurement via Securities Markets by Publicly Traded Japanese Companies

(in billions of yen)

	1985		1986		1987		1988	
	Value	Share	Value	Share	Value	Share	Value	Share
Domestic Market								
Straight Bonds	Y590	9.5%	Y615	8.0%	Y820	7.1%	Y873	7.1%
Convertible Bonds	1,790	28.8	2,564	33.5	4,571	39.7	4,135	33.8
Warrant Bonds	10	0.2	84	1.1	33	0.3	0	0.0
Equity	548	8.8	658	8.6	1,521	13.2	2,410	19.7
Total	2,938	47.3	3,921	51.2	6,945	60.3	7,417	60.6
Foreign Markets								
Straight Bonds	1,464	23.6	1,555	20.3	1,127	9.8	615	5.0
Convertible Bonds	1,133	18.2	278	3.6	394	3.4	658	5.4
Warrant Bonds	672	10.8	1,906	24.9	3,057	26.5	3,548	29.0
Total	3,269	52.7	3,739	48.8	4,578	39.7	4,821	39.4
Total	6,206	100.0	7,659	100.0	11,524	100.0	12,239	100.0

Source: Tokyo Stock Exchange

Table 3: Fund Procurement via Securities Markets by Japanese Financial Institutions

(in billions of yen)

	1985		1986		1987		1988	
	Value	Share	Value	Share	Value	Share	Value	Share
Domestic Market								
Convertible Bonds	Y130	19.0%	Y180	24.5%	Y683	23.3%	Y2,459	46.7%
Warrant Bonds	0	0.0	32	4.3	0	0.0	0	0.0
Equity	311	45.4	215	29.1	1,492	50.9	2,373	45.1
Total	441	64.5	427	57.9	2,175	74.2	4,832	91.8
Foreign Markets								
Straight Bonds	53	7.8	14	1.9	2	0.1	9	0.2
Convertible Bonds	169	24.7	156	21.2	609	20.8	267	5.1
Warrant Bonds	21	3.0	139	18.9	146	5.0	154	2.9
Total	243	35.5	310	42.1	757	25.8	430	8.2
Total	684	100.0	736	100.0	2,932	100.0	5,261	100.0

Source: Tokyo Stock Exchange

September of this year. The paper estimated that Y6,507.7 billion ($46.5 billion) was raised on foreign markets during this period compared with Y5,799.6 billion ($41.4 billion) reaped from domestic markets. Nikkei said that Japanese firms have adopted a straightforward approach to raising funds through bonds, issuing them in the most advantageous market regardless of its location.

The data indicate that Japanese corporate finance is changing under the impact of domestic financial liberalization, becoming more sensitive to market forces. In turn, global financial markets will be forced to change as the competition for the ever-growing needs of Japanese business becomes more intense.

Jon Choy

Pachinko Payoffs: Another Recruit Scandal?

The Japanese media has touched off what may be Japan's next political scandal -- this one involving the Japan Socialist Party's relationship with the pachinko (pinball machine) industry. Shukan Bunshun, a popular weekly magazine, in early August published a special series that accused the Socialists of receiving substantial political contributions from pachinko parlor operators in 1984 in return for influencing Diet debate on legislation that would have tightened controls on the industry. Pachinko is Japan's most popular form of legalized gambling.

The magazine also maintained that some JSP legislators pressured the police to refrain from enforcing the introduction of prepaid cards in pachinko parlors. Prepaid cards would make it easier to document the earnings of an industry that from 1984 to 1988 was Japan's largest tax evader. In addition, Shukan Bunshun contended that some Socialist Diet members received political contributions from Chongryon (General Association of Korean Residents in Japan), a pro-North Korean organization, in violation of Japan's political contributions law, which prohibits the receipt of funds from foreigners or groups representing foreigners.

Although the story has been simmering for about two months, the ruling Liberal Democratic Party has seized the so-called pachinko payoff scandal during the current extraordinary Diet session in an apparent effort to redress the losses it incurred in the upper house of the Diet as a result of the Socialists' stunning victory in the July 23 House of Councillors elections. LDP secretary general Ichiro Ozawa told the press October 6 that his party will try and come down as hard as possible on the JSP. Following this warning LDP member Koichi Hamada October 17 proposed before the House Budget Committee that a JSP legislator and the author of the Shukan Bunshun article be summoned to the Diet to testify under oath about the affair.

The magazine alleged that Ippei Koyama, a JSP member of the upper house, received a political contribution from Chongryon. Approximately 60 percent of pachinko parlor owners are said to be Korean nationals residing in Japan who remain sympathetic to the economic and foreign policy interests of either Seoul or Pyongyang. The JSP is the only political party in Japan that favors normalization of relations with North Korea.

The Socialists rejected Mr. Hamada's proposal, arguing that a summons is inappropriate and too hasty. JSP officials insisted that Mr. Koyama did not